Office of Chief Counsel
Internal Revenue Service

memorandum

CC:DOM:IT&A:1
JJMcGreevy WTA-N-108252-97

date: JUL - 7 1997

to: Director, Office of Field Services C:AP:FS

from: Assistant Chief Counsel (Income Tax & Accounting)
CC:DOM:IT&A

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subject: Request for Assistance

This is in response to your March 19, 1997, memorandum regarding the proper order in which to apply credits to an account when there is a deficiency that the taxpayer has prepaid with an advance payment and an overpayment of tax is later determined for an earlier tax year.

ISSUE

Whether an overpayment may be credited against a deficiency that has been prepaid by an advance payment.

CONCLUSION

An overpayment may not be credited against a deficiency that has been prepaid by an advance payment.

FACTS

Your memorandum presents the following example. A taxpayer has two open years in Appeals (1984 and 1985). The 1985 tax year (due date March 15, 1986) will result in a deficiency of $15 million. The 1984 tax year (due date March 15, 1985) will result in an overpayment of $10 million. The computation of underpayment and overpayment interest for the two years depends on how the deficiency for 1985 is satisfied. Both tax years will be closed on June 10, 1996.

Without an advance payment of the deficiency for 1985, the 1985 deficiency can be satisfied by the 1984 overpayment. The $10 million overpayment for 1984 will accrue overpayment interest from March 15, 1985, to March 15, 1986. The $10 million overpayment and accrued overpayment interest is then applied to the $15 million deficiency as of March 15, 1986. Underpayment interest on the excess of the $15 million deficiency over the overpayment and accrued interest will be calculated from March 15, 1986, to the date paid.

With a $15 million advance payment of the 1985 deficiency on January 3, 1996, that is applied to the deficiency before the 1984 overpayment is applied, overpayment interest will accrue on the 1984 overpayment from March 15, 1985, to the date of refund. Underpayment interest will run on the deficiency from March 15, 1986, to January 3, 1996. If the underpayment is satisfied by a payment the net effect is that the taxpayer pays the difference between the underpayment interest rate and the overpayment interest rate (the interest rate differential) on $10 million from March 15, 1986, to January 3, 1996.

DISCUSSION

The statutory framework for calculating interest on underpayments and overpayments is contained in sections 6601 and 6611 of the Internal Revenue Code, respectively. The payment of interest on underpayments and overpayments under these provisions is mandatory unless specifically prohibited by law.

Section 6601(a) provides that if any amount of tax imposed by the Code (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the underpayment rate established under § 6621 shall be paid for the period from such last date to the date paid.

Section 6611(a) provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax. Section 6611(b) states that interest shall be allowed and paid, in the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken, and in the case of a refund, from the date of the overpayment to a date (to be determined by the Secretary) preceding the date of the refund check by not more than 30 days.

Section 6402(a) states that in the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c), (d), and (e), refund any balance to such person. Section 301.6402-1 of the Regulations on Procedure and Administration provides that the credit may be made against any "outstanding" liability for any tax.

Section 6601(f) provides that if any portion of a tax is satisfied by credit of an overpayment, then no interest shall be imposed under § 6601 on the portion of the tax so satisfied for any period during which, if the credit had not been made, interest would have been allowable with respect to such overpayment.

Section 6402(a) permits the Service to credit an overpayment against an <u>outstanding</u> liability for tax. If the liability is

satisfied by the application of a credit pursuant to § 6402(a), then § 6601(f) provides that the interest otherwise determined under the rules set forth in § 6601 will not be charged during any period for which overpayment interest would be payable if the credit had not been made (i.e., during the period of mutual indebtedness). This result cannot be achieved merely by treating a previously paid tax liability (i.e., one that is no longer outstanding) as unpaid for interest calculation purposes. That is, credits cannot be allowed as if the overpayment had not previously been refunded and/or the tax liability had not previously been paid. The argument that § 6402(a) provides the Service with the authority to allow such treatment, for the purpose of invoking § 6601(f), was rejected in Northern States Power Co., v. United States, 73 F.3d 764 (8th Cir. 1996), cert. denied, 117 S.Ct. 168 (1996).

Courts have generally held that a remittance is treated as a payment of tax if the remittance discharged what the taxpayer deemed a liability or paid one that was asserted. See Rosenman v. United States, 323 U.S. 658, 662 (1945). For the majority of courts, as for the Service, the actual assessment of tax is not a prerequisite to treatment of a remittance as a payment of tax. See, e.g., Moran v. United States, 63 F.3d 663 (7th Cir. 1995), and cases discussed therein.

The Service subscribes to the view that the facts and circumstances of each case must be reviewed to determine if a remittance constitutes a payment of tax. Rev. Proc. 84-58, 1984-2 C.B. 501, provides guidance in making this determination. For example, under Rev. Proc. 84-58 a remittance can be treated either as a payment of tax or as a deposit in the nature of a cash bond. An undesignated remittance will be treated as a deposit by the Service and may be returned at any time prior to the issuance of the revenue agent or examiner's report. When the report is issued the remittance will be treated as a payment since it satisfies a proposed (but unassessed) tax liability. A remittance that is designated by the taxpayer in writing as a deposit in the nature of a cash bond will be treated as such by the Service. The taxpayer may request the return of all or part of the deposit at any time before the Service is entitled to assess the tax. See Rev. Proc. 84-58, section 4.02(1).

If an advance payment constitutes a payment of a deficiency in tax, then there is no outstanding liability against which to apply an overpayment when it is ultimately determined. There is no authority to reverse a payment credit in order to substitute an overpayment credit for interest computation purposes to avoid the interest rate differential. If the advance payment is found to constitute a deposit then the payment could be returned to the taxpayer and the overpayment could be used to satisfy the deficiency.

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If you have any questions regarding this memorandum, please contact John McGreevy at 622-7506.

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